

Message Text

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ACTION EB-07

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C O N F I D E N T I A L LUXEMBOURG 0462

E.O. 11652: GDS

TAGS: EFIN, LU

SUBJ: PROPOSED GOL ACTION TO INCREASE CONTROL OVER FOREIGN
BRANCH BANKS

SUMMARY: GOL BANKING COMMISSION HAS ISSUED INSTRUCTIONS
FOR BRANCH BANKS TO ADHERE TO SOLVENCY RATIOS. DIRECTIVE
IS CAUSING CONCERN AMONG AMERICAN BRANCHES AND, IF
ENFORCED, COULD LEAD US BRANCHES TO CURTAIL OPERATIONS
IN LUXEMBOURG. END SUMMARY.

1. ALBERT DONDELINGER, GOL BANKING COMMISSIONER, IN A
RECENT CIRCULAR LETTER, HAS DIRECTED BRANCH BANKS IN
LUXEMBOURG TO MAINTAIN THE SAME SOLVENCY RATIOS
(CAPITAL/DEPOSITS) THAT LUXEMBOURG INCORPORATED BANKS
DO. CURRENT GOL REGULATIONS STATE THAT THE REQUIRED
CAPITAL RATIO IS THREE PERCENT, THAT IS, BANKS ARE
ALLOWED TO EXPAND THEIR BALANCE SHEETS UP TO 33 TIMES
THEIR SOCIAL CAPITAL.

2. ALTHOUGH NOT DIRECTED SOLELY AT BRANCHES OF US
BANKS (7 OF THE 15 BRANCH BANKS IN LUXEMBOURG ARE
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AMERICAN), US BRANCHES ACCOUNT FOR A LARGE SHARE OF

EURO-CURRENCY LOAN ACTIVITY IN THE MARKET, AND NEARLY ALL OF THEM ARE CURRENTLY OPERATING AT SOLVENCY RATIOS INFERIOR TO THOSE REQUIRED BY THE BANKING COMMISSION. SEVERAL US BANKERS HAVE INDICATED THAT THEIR BANKS WOULD PROBABLY LEAVE LUXEMBOURG OR DRASTICALLY CUT-BACK THEIR ACTIVITY IF DONDELINGER PERSISTS IN THIS ACTION. THEY POINT OUT THAT, HERETOFORE, THE SOLVENCY RATIOS HAVE NEVER BEEN APPLIED TO BRANCH OPERATIONS SINCE IT HAD BEEN ASSUMED THAT THE CAPITAL OF THE HOME OFFICE STOOD BEHIND EACH BRANCH. BANKERS ALSO CLAIM THAT THE SOLVENCY RATIO AS CURRENTLY CALCULATED GIVES A FALSE PICTURE OF THEIR SOLVENCY POSITION SINCE A LARGE SHARE OF THEIR LOAN ACTIVITY INVOLVES TRANSACTIONS BETWEEN THE HOME OFFICE AND THE BRANCH.

3. EMBASSY ECON OFFICER DISCUSSED THIS MATTER WITH DONDELINGER JUNE 18, RELAYING THE CONCERN EXPRESSED BY US BANKERS. DONDELINGER STATED THAT THE REGULATION HAD BEEN ON THE BOOKS FOR SOME TIME AND THAT THERE WERE NO EXCEPTIONS FOR BRANCH BANKS. AS TO THE TIMING FOR BRINGING BRANCHES WITHIN THE SOLVENCY RATIO, DONDELINGER SAID THAT HE WOULD BE FLEXIBLE AND LOOK AT INDIVIDUAL BANK PROBLEMS ON A CASE-BY-CASE BASIS. DONDELINGER SAID THAT HOME OFFICES COULD EITHER TRANSFER MORE CAPITAL TO THEIR LUXEMBOURG BRANCHES OR THE BRANCHES COULD REDUCE THEIR ACTIVITY TO CONFORM WITH THE SOLVENCY RATIO. WHEN WE POINTED OUT TO DONDELINGER THAT THE FEDERAL RESERVE PLACES CERTAIN LIMITS ON CAPITAL TRANSFERS OVERSEAS AND THAT THIS MIGHT POSE DIFFICULTIES, ESPECIALLY FOR SMALL US BANKS, DONDELINGER SAID THAT HE HAD SPOKEN TO FED REPRESENTATIVES AT RECENT MEETING IN BASEL AND THAT THEY ASSURED HIM THAT SUCH LIMITATIONS WERE GLOBAL RATHER THAN SPECIFIC. DONDELINGER CONCLUDED THAT THE HOME OFFICES OF US BRANCHES THEREFORE COULD DECIDE TO SHIFT CAPITAL FROM THE BAHAMAS OR OTHER OVERSEAS BRANCHES TO LUXEMBOURG IF THEY SO DESIRED.

4. WE ALSO POINTED OUT TO DONDELINGER THAT HIS LATEST DIRECTIVE APPEARED TO CONTRADICT HIS PREFERENCE FOR AN ARRANGEMENT BETWEEN CENTRAL BANKERS WHEREBY THE CENTRAL

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BANK OF THE PARENT BANK WOULD ASSUME RESPONSIBILITY FOR BRANCH OPERATIONS IN OTHER COUNTRIES. DONDELINGER REPLIED THAT THIS PROCEDURE, WHICH HE STILL FAVORS, IS A LONG TERM SOLUTION AND WILL REQUIRE NEW LEGISLATION IN ORDER TO ALLOW OTHER CENTRAL BANKS, INCLUDING THE FEDERAL RESERVE, TO MONITOR BRANCH OPERATIONS IN LUXEMBOURG, SINCE SUCH SURVEILLANCE IS NOW PROHIBITED UNDER LUXEMBOURG'S BANK SECRECY LAWS. DONDELINGER ADDED

THAT HIS STAFF IS WORKING ON THE PROBLEM NOW AND HE HOPES TO SUBMIT LEGISLATION BY THE END OF 1975.

5. COMMENT: WE BELIEVE THAT DONDELINGER IS TESTING THE BANKING COMMUNITY'S RESPONSE TO HIS DIRECTIVE. AT THE SAME TIME, HE MAY BE PROTECTING HIMSELF FROM FUTURE CRITICISM FROM THE FINANCE MINISTER. THE BANKING CENTER CANNOT AFFORD TO SEE ITS REPUTATION DAMAGED BY THE EXODUS OF SEVERAL BRANCHES AND DONDELINGER KNOWS THIS. AS IN PAST INSTANCES WHEN HIS INITIATIVES HAVE FALLEN ON DEAF EARS (I.E., THE LIQUIDITY BANK SCHEME), WE BELIEVE THAT HE WILL GRADUALLY RETREAT FROM THIS LATEST DIRECTIVE. WE WILL CONTINUE TO MONITOR THE SITUATION CLOSELY.

7. ACTION REQUESTED: CLARIFICATION OF FEDERAL RESERVE POLICIES WITH RESPECT TO OVERSEAS BRANCH OPERATIONS OF US BANKS, INCLUDING THE FED'S RESTRICTIONS ON TRANSFERS OF CAPITAL TO OVERSEAS BRANCHES.

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